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## Romania

### Trade Policy Monitoring

### EU Accession: Expected Short Term Impacts on Romania's Agri-Food Sector

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**Report Highlights:**

Romania's recent accession to the European Union (EU) is expected to have a significant impact on the country's agricultural sector. The biggest changes will come from adoption of the Common Agricultural Policy (CAP), new regulatory requirements, and application of new external tariffs. Despite substantial EU assistance ready to be disbursed under pillar I (market measures) and pillar II (rural development), legacy structural problems in rural areas will significantly limit the country's potential to absorb funding.

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## EXECUTIVE SUMMARY

Romania's recent accession to the European Union (EU) is expected to have significant impact on the country's agricultural sector, as a result of the integration into the Single Market and the adoption of the Common Agricultural Policy (CAP). Intra-community movement of goods, strengthened by removal of trade barriers and supported by the freer movement of labor and capital, should stimulate competition and force local producers to adapt themselves to new standards, resulting in quality increases and availability of a wider range of products. Prices should normally converge towards EU levels. In the short run, increases in staple food prices are expected (which in absolute terms were about half of the average EU-25 level (EC, 2005). Increases will vary from sector from sector. Indeed, in anticipation of accession, some consumer prices in Romania have been rising for the past 3-4 years and are now higher than their EU equivalents (meats and dairy products in particular).

Legacy problems in agriculture and in rural areas could actually worsen in the short run, although EU assistance should alleviate some of the difficulties.

## KEY PROBLEMS IN ROMANIAN AGRICULTURE

The 2004 enlargement with ten new Member States expanded the EU's total number of registered farms by about 70 percent. Today, Romania and Bulgaria account for about 50 percent of the farms in the EU-25.

Romania's production structure in the farming sector continues to represent a major challenge for the country, including from the perspective of its potential to absorb EU funds. Some of these issues can be summarized as follows:

- Fragmented and small agricultural holdings (large number of subsistence and semi-subsistence farms, with low agricultural profitability).
- Rural unemployment and poverty.
- Low rural education skills.
- High dependence on government transfers.
- Insufficient modernization and marketing expertise in primary food processing.
- Underdeveloped rural infrastructure and supporting institutions.

A recent report of the Romanian National Institute of Statistics (based on the Agricultural Structural Survey)<sup>1</sup> indicates that, at the end of 2005, 71 percent of Romania's farms were under the EU economically viable size threshold (that is, 1200 Euros). The 29 percent of the "viable" (according to this definition) holdings farm 74.4 percent of Romania's agricultural land. By comparison, such units work 99 percent of the agricultural area in the Czech Republic, almost 95 percent in Hungary, 89 percent in Poland. In other words, subsistence farming is still prevalent in the Romanian agriculture.

The total number of agricultural holdings decreased by 5 percent in Romania in 2005 versus 2002, to 4,256,152 from 4,484,893. The average size of the individual farm was 2.15 HA (as compared to 1.73 HA in 2002), while the average size of the farms registered as legal persons shrank from 274.4 HA in 2002 to 263.1 HA in 2005.

Land tenure is changing even more rapidly. In 2005, 74.5 percent of the total farmed area was owned by the agricultural holdings, 14 percent was leased, while the balance was made up of long-term concessions, free of charge arrangements etc.

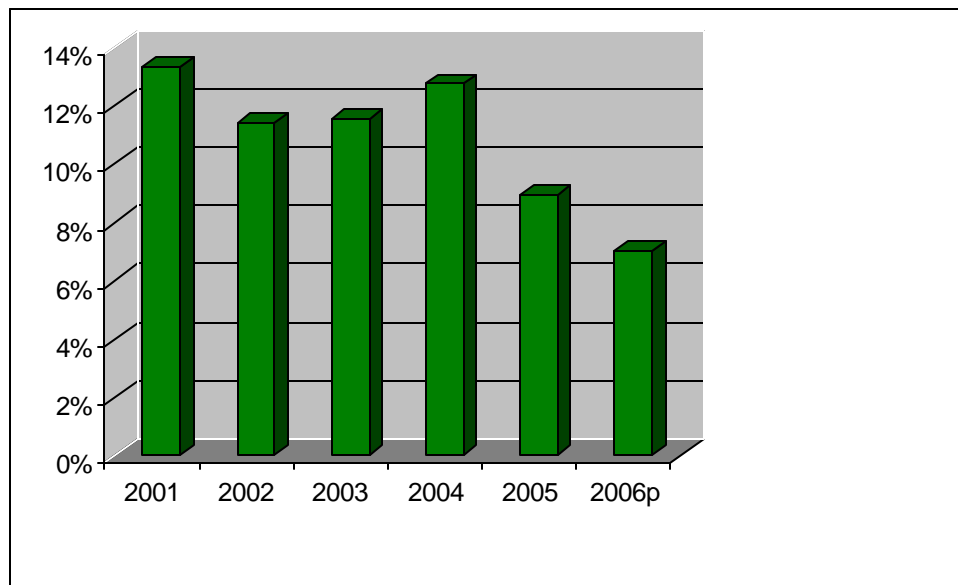
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<sup>1</sup> Conducted every 2-3 years in the Member States. In Romania, the 2006 sample comprised 361,000 farms (i.e. about 8 percent of the total number of farms registered by the 2002 census).

Even though going down, employment in agriculture continues to be very high by EU standards. In 2005, the total amount of work in this sector was 2.35 million AWU (Annual Work Units<sup>2</sup>), down 5 percent from 2002.

On the background of a pretty solid economic growth nationwide (reaching close to 8 percent in 2006), the share of agriculture in Romania's GDP is going down rapidly, but is still the highest in the enlarged EU.

**Figure 1. Share of Agriculture, Forestry and Fisheries in Romania's GDP ( percent)**



## EU FUNDING

Some of these issues are expected to be effectively addressed through the EU assistance, especially the structural and cohesion funds (SCF), meant to alleviate disparities among various EU regions. For Romania, the total SCF package for 2007-2013 amounts €19.7 billion, under three components: the Regional Development European Fund (EFRD, focusing on regional development, environment, competitiveness, technical assistance, inter-regional cooperation within the EU), the Social European Fund (SEF, under which projects related to human resources development and administrative capacity strengthening are eligible) and the Cohesion Fund (CF, addressing environmental protection and infrastructure<sup>3</sup>). Such funding may cover up to 85 percent of the total cost of a project, with the balance coming from the national budget.

<sup>2</sup> AWU represents a measurement unit for full time agricultural work (i.e. 8 hours per day for 245 working days a year).

<sup>3</sup> Such projects are eligible only if the regional GDP/capita is below 90 percent of the EU average.

Within the national envelope, each country prepares a strategy for using the funding (except for the major projects, that are to be approved individually by the EU Commission<sup>4</sup>).

Various regions in Romania easily qualify for finance under the Cohesion Fund, based on its convergence criteria. The Cohesion Fund is meant to alleviate disparities among regions at the EU level. A study of the Romanian Institute for Economic Forecast shows that the economic gap between Bucharest and the rest of the country will grow wider in the coming years. It is anticipated that the GDP will go up in Romania's capital by 7.2 percent in 2007 and further by 6.8 percent in 2008. The poorest part of the country, the North-East Region, will have the second highest economic growth rate, forecast to reach 6.6 percent in 2007 and, respectively, 6.4 percent in 2008.

Current estimates nonetheless assess that in 2007 and 2008, Romania's absorption rate for structural funding may vary among to 5-15 percent.

In addition to structural funds, Council Regulation 1290/2005 regarding the financing of the common agricultural policy created the legal framework for the two funds dedicated to agriculture: EAGF (European Agricultural Guarantee Fund) aiming to finance Pillar I measures (market policies) and EAFRD (European Agricultural Fund for Rural Development) for financing rural development programs within Pillar II of CAP. EAFRD contributes to the promotion of sustainable rural development in the EU, complementing the market and income support policies implemented within the common agricultural policy, the cohesion policy and the fishery common policy.

The budgetary allocation for Romania under these two types of assistance totals €12.3 billion for the period 2007-2013. This funding is to cover direct payments to farmers (of about €5 billion) and, respectively, investment projects in agriculture and rural development (totaling €7.3 billion). While direct payments will be phased in until 2016 (commencing in 2007 at 25 percent of the support level applicable in the EU-15), budgetary outlays for market support and rural development will be 100 percent payable at the level of EU-15 from the first year of accession.

In 2006, the two agencies responsible for managing EU funding for agriculture received accreditation and became operational. The Paying Agency for Intervention in Agriculture (APIA) will administer payments related to market policies. The Paying Agency for Rural Development and Fishery (APDRP, the former SAPARD Agency<sup>5</sup>) is responsible for rural development project financing in Romania. APDRP will continue to implement the SAPARD Program and will also carry out the technical and financial implementation of the European Fund for Agriculture and Rural Development (EFARD) and of the European Fund for Fishery (EFF). The financing procedures for investments is laid down in the National Program for Rural Development for 2007 – 2013, which is being elaborated by the Ministry of Agriculture, Forests and Rural Development (MAFRD).

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<sup>4</sup> Environment projects of over €25 million (eligible to be covered from EFRD) are considered major. Likewise, projects with a size of minimum €50 million from categories other than environmental protection are described as major.

<sup>5</sup> The Agency has a central unit, eight Regional Paying Centres for Rural Development and Fishery and one Field Paying Office in each county. In addition to fulfilling the paying function for investment projects, financed by the European Fund for Agriculture and Rural Development and by European Fund for Fisheries, the Agency is responsible for payments for Sapard projects contracted up to the end of 2006 and will technically and financially implement the European Fund for Agriculture and Rural Development and the „Romanian SAPARD” program.

The absorption rate for SAPARD funds accelerated significantly in 2006, so that the funds were entirely committed 5 months before the deadline – 31st of December<sup>6</sup>. Contacting and spending under the pre-accession SAPARD assistance continues gradually until the end of 2008.

### **Pillar I: Market Measures**

Similarly to the 10 member states who joined the Union in 2004, Romania is gradually introducing direct payments over a period of ten years with the following schedule of increments expressed as a percentage of the then applicable level of such payments in the EU-15: 2007 – 25 percent, 2008 – 30 percent, 2009 – 35 percent, 2010 – 40 percent and thereafter in 10 percent increments so as to reach the support level then applicable in the EU-15.

From the first year of accession, the amounts budgeted in direct payments can be supplemented by top-ups out of national funds (or through switching Rural Development funds in the first 3 years after accession, as Romania chose to). The complementary national payments (NCDP) should not exceed 55 percent of the value of direct payments in the EU in the first accession year, 60 percent in the second year and 65 percent in the third; beginning with the fourth year, maximum 30 percent above the level of payments of the respective year.

Romania opted for the Single Area Payment Scheme (SAPS) for the three years of membership, after which it may switch to Single Farm Payment (if the Integrated Administration and Control System – IACS – is improving so that to administer the single payment scheme – SPS). The minimum eligible farm size was set up at 1 HA, while the minimum eligible plot is 0.3 HA. Full cross-compliance rules should apply at the end of the three years, regardless of whether SAPS or the Single Farm Payment is applied from then on.

SAPS provides farmers with a uniform per HA lump sum, payable once a year, regardless the crops planted and regardless whether cultivated or not (under the sole condition of maintaining the soil in proper agronomic condition). At the end of 2007, based on the number of eligible applicants, the Ministry of Agriculture estimated that this will be roughly €50/HA (without top-ups).

According to Agriculture Minister's Order 607/Aug 2006, a number of products are eligible for top-ups augmenting the direct payments from the EU Commission, as follows: 1<sup>st</sup> group: arable crops: wheat, rye, barley, oat, maize and sorghum, sunflowerseeds, rape seeds, peas, field beans and sweet lupine; 2<sup>nd</sup> group: industrial crops: sugar beat, rice, hops, tobacco, flax and hemp for fiber and non-GM soybeans.

As a result of its negotiations with the EU, Romania's envelope for CAP implementation for 2007-2009 amounts to over €4 billion. Of these, the budgetary outlays for direct aid will total roughly €967.9 million. The first payments will be disbursed to farmers from October 2007 from the budget of the Romanian Ministry of Agriculture, amount that will be reimbursed by the Commission from the 2008 budget<sup>7</sup>.

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<sup>6</sup> 60 percent of the SAPARD funds were committed during 2005-2006, and 40 percent in 2002-2004.

<sup>7</sup> Financial support to products or sectors for which quotas, reference areas or national ceilings were set up.

Allocations for *market measures* for 2007-2009 will total €732 million, in the form of market interventions (price support through buying the surplus production and its storage in public or private stocks) and export refunds<sup>8</sup>.

## Pillar II: Rural Development

EAFRD is an instrument that complements the national, regional and local measures and should be compatible with the economic and social cohesion objectives and with those of the Instrument for Community Aid in the fishery sector, and with the measures financed by the European Agricultural Guarantee Fund.

According to C.R. 1698/2005, each Member State has to submit a national strategic plan considering the strategic orientation of the Community, the priorities of the EFARD and of the Member State itself, as well as their specific objectives and the financial planning (EFARD contribution and the other financial resources). The measures<sup>9</sup> a member state can select among are quite numerous (37), divided into three axes<sup>10</sup>. Additionally, LEADER axis provides the general framework and action methods at local community level.

Within this framework, Romania proposed ten measures for Axis 1, four measures for Axis 2 and five measures for Axis 3. Of the total EFARD funds of 8.022 billions EURO for 2007-2013, 7.3 billions will be allocated to rural development and the balance will augment funding for direct payments (Table 1).

**Table 1. Romania's Priority Measures for EFARD Funding**

Measures	percent of project's cost EU+national budget	Eligible Applicants
<b>Axis 1: Improving the competitiveness of the agricultural and forestry sector 45 percent of the total, €3.25 billion</b>		
Investments for modernising agricultural holdings	max 65 percent	Agricultural producers (farmers), individuals or legal persons, who can ensure 50 percent matching funds (40 percent for young farmers, farmers in mountain areas and in disadvantaged areas)
Investments for setting up processing units for agricultural products and modernising forestry units	max 50 percent	Micro-, small and medium size enterprises in agricultural and forestry
Support for semi-subsistence farms	1500 €/year/farm	Semi-subsistence farms (which are to be defined) that submit a business plan proving the future viability of the farm
Investments for modernising the agricultural and forestry infrastructure	100 percent	Agricultural producers, their associations, local councils, forest owners and their associations
Assistance for establishing	100 percent	Producer groups legally set up before December

<sup>8</sup> For merchandise like milk and dairy, beef, cereals, fruits and vegetables, sugar products, processed products, etc.

<sup>9</sup> „measure”: a set of operations contributing to the implementation of an axis.

<sup>10</sup> „Axis”: a coherent group of measures with specific goals resulting directly from their implementation and contributing to one or more of the objectives.

Measures	percent of project's cost EU+national budget	Eligible Applicants
producer groups		31, 2013
Vocational training of agricultural and forestry producers	100 percent	Final beneficiaries in the agricultural sector: - agricultural producers (farmers), legal or natural persons; - employees in agriculture, food processing and wood processing industry.
Support for young farmers who settle down in rural areas	100 percent	Young farmers (under 40), owners of a farm for the first time, with appropriate qualification who submit an investment plan.
Support for early retirement	100 percent	Land owners over 55 who worked in agriculture for at least 10 years and give up their commercial agricultural activity and transfer the ownership to young people. Agricultural workers over 55 years old, who contributed to a social aid plan and who worked minimum 2 years in the last 4 years in a farm that is going to be given up.
Agricultural and forestry advisory services	100 percent, max 150 €/farm	Final beneficiaries for the agricultural sector: agricultural producers (farmers), legal and natural persons.
Investments to increase the economic efficiency of forests	max 60 percent	Forests owners and their associations
<b>Axis 2: Improving the environment and the countryside 25 percent of the total, €1.8 billion</b>		
Area support for less favoured areas from the natural condition point of view (mountain area)	100 percent	Users of agricultural lands
Area support for agri-environment (pastures, organic farming)	100 percent	Users of agricultural lands
Support for the premium for afforestation of agricultural land	80 percent	Owners of agricultural land And their associations
Support for the premium for afforestation of non-agricultural land	70 percent	Owners of non-agricultural land And their associations
<b>Axis 3: Improving the quality of life in rural areas 27.5 percent of total, about €2 billion</b>		
Investments for developing non-agricultural activities	50 percent	Members of the agricultural households
Investments for setting up and developing micro-enterprises	max 65 percent	Micro-enterprises
Investments for developing rural tourism	max 65 percent	Farmers and other economic entities



Measures	percent of project's cost EU+national budget	Eligible Applicants
Investments for rehabilitation of villages	100 percent	Local councils
Support for organising and developing public-private – LEADER partnerships	100 percent	Public and private organisations
<b>Axis 4: LEADER</b> <b>2.5 percent of total, €180.5 million</b>		
Operation expenses of the groups for local action (GLA)	100 percent	Groups for local action
Support for implementing projects included in the local development strategies	100 percent	Local communities, public and private structures

Source: The European Institute of Romania, Pre-accession Impact Studies, Study No. 5, based on the National Strategic Plan and NPRD.

## DAIRY MARKET

The total national reference quantity for milk set for Romania within country's EU accession negotiations is 3,057,000 MT, of which 1,093,000 MT for deliveries and 1,964,000 MT for direct sales. To this, a "Reserve" quota of 188,000 MT might add in 2009 (counting for current on-farm consumption). The figure places Romania the second among the States from the Eastern bloc that joined the EU (Table 2).

**Table 3. EU Allocation of Milk Quotas to Central-Eastern Countries (MT)**

Country	Original country request	Final EU offer	Reserve for 2006 *
Czech Rep.	3,100,000	2,682,143	55,788
Estonia	900,000	624,483	21,885
Hungary	2,800,000	1,947,280	42,780
Latvia	1,200,000	695,000	33,253
Lithuania	2,250,000	1,646,939	57,900
Poland	13,740,000	8,964,017	416,126
Slovakia	1,235,900	1,013,316	27,472
Slovenia	695,000	560,424	16,214
Bulgaria			
Romania	5,000,000	3,057,000	188,000

\*2009 in the case of Bulgaria and Romania

Source: Cochrane; U.S. -EU Food and Agricultural Comparisons; Babcock Inst. Discussion Paper No 2005-3.

The Ministry of Agriculture, Forests and Rural Development decided that all producers, regardless the number of cows they own, are eligible to participate in the EU milk quotas. Initial estimations indicate that about 600,000 farmers will be recipients of milk quotas.

The reference cows in milk population able to supply the quota negotiated with EU with is 826,200 heads. If after accession the country is not able to fulfill the whole production quota allocated by EU, the unsupplied amount will be lost and the quota diminished accordingly.

The process of registration and individual quota allocation will end in March 2007. After this, those producers whose production exceeds their quota will have to pay high levies for the extra milk delivered. Those farmers who are not granted a quota will be not eligible for commercial sales after accession. Nonetheless, farmers will be able to go on the free market to buy or sell quotas.

On the background of a very disbursed supply, with strong seasonal trait, current collection levels of raw milk supply for commercial use of domestic continues to be modest, less than one forth of the total. Milk sanitation and collection continues to improve, driven by both the presence of international operators in the sector and the increased access to EU equipment subsidies that support small rural operators. Nonetheless, it is still an important constraint to the processing industry: if the maximum number of germs per ml of raw milk should not exceed 100,000 by EU standards, most Romanian farmers supply milk with a contamination of over 1 million germs/ml<sup>11</sup>.

Industry representatives believe that after the first year of Romania's European membership, the amount of milk processed domestically will double, reaching 2 million MT, in parallel with a reduction in so-called "direct sales". If purchasing power growth may normally trigger a 2-3 percent annual increase in the processed milk product market, the shrinking of the gray and black markets is estimated to result in a 10-15 percent growth in demand for processed products. A number of priorities remain still to be addressed: improvements in feed and forage practices at farm level for specialized dairy breeds, advanced techniques for animal husbandry, etc.

**Table 3. Evolution of Cow Milk Production and Distribution in Romania**

	2003	2004	2005	2006 <sup>p</sup>
Average no. of cows in milk (thou heads)	1,694.60	1,587.20	1,576.60	1,582.10
Total Milk Production (thou HL)	55,288.20	55,619.4	56,565.9	n.a.
Yield (liters/head)	3,263	3,504	3,588	3,650
Used as feed ( percent)	12	12	11	11
Used on farm (self-consumption) ( percent)	41	38	39	39
Direct sales ( percent)	24	26	27	28
Delivered for processing ( percent)	23	24	23	22

p – provisional.

Source: Romanian Ministry of Agriculture, Forests and Rural Development

Direct sales consist of sales of raw, non-pasteurized milk to final consumers (especially in the rural areas). Expected to shrink, this channel currently absorbs over a quarter of the milk domestic production (Table 3).

Another 11-12 percent of the total production is used as feed, while the balance, still very significant, covers the household self-consumption.

<sup>11</sup> Dairy Industry Employer Association chairman quoted by *Bursa* daily.

The dairy product market registered an average growth rate of 2.5 percent over the past three years. Industry representatives expect that in 2005 this growth will exceed 3 percent, taking the overall value market to almost EURO 700 billion.

Romanian milk and dairy product consumption lags Western Europe and is low even in the regional context<sup>12</sup>. Nonetheless, the 5 percent growth rate of the market in 2005 is one of the highest in Europe. It is certain that country's EU accession will bring important structural changes related to a rapid expansion of the share of processed milk products for consumption at the expense of the non-pasteurized, traditional home-made products, still available in smaller rural markets. In fact, on January 18, 2007, the Veterinary and Food Safety Authority was going to enforce its Order 301/2006, according to which only dairy producers authorized as compliant with EU norms were going to be allowed to sell their merchandise. The attempt faced a huge opposition from both the small dairy manufacturers and urban consumers, who protested against the implementation of this regulation and blamed the Government authorities for performing poorly when negotiating with Brussels transition measures for local traditional products. Consequently, enforcement of Order 301/2006 was deferred with 6 months.

Romania requested a transitional period until December 31, 2009 for modernizing and re-vamping the milk processing plants and for the organizing the milk collection and standardization centers in order to comply with the Community structural requirements. Products from establishments subject to transitional arrangements will not be sold to other Member States and will be clearly identified (labeled).

As of October 2006, there are 59 establishments approved to export to EU (falling under "A" category), while another 188 were expected to be EU compliant by January 1, 2007 (the "B" category). In the "C" category, there were 74 dairy plants (i.e., expected to meet the EU requirements by the end of 2009). In the "D" category (to be shut down by the date of accession) there were 8 operations.

By comparison, in 2004, there were just 27 milk-processing establishments expected to comply with EU requirements by the date of accession and 28 units under transitional measures (category "C").

The HACCP system in dairy establishments in Romania was introduced on October 1, 2006 (per Article 14 of Directive 92/46/EEC transposed into the national legislation).

As regards the request for a transitional period relating to raw milk, such milk is channeled only to establishments located in Romania and controlled by the General Veterinary Inspectorate. Non-compliant raw milk and raw milk from non-compliant farms can be delivered for processing only to establishments benefiting from a transitional period.

Romania requested for the traditional cheese brands Nasal, Bradet, Homorod (smoked cheese) application of the provisions of Decision 97/284/EC.

## Trade

Despite country's pretty high milk supplies, Romania has been for the past 10 years (i.e. after agricultural trade liberalization under a WB's Agricultural Sector Adjustment Loan) a net importer of most dairy processed products, with the notable exception of cheese<sup>13</sup>. The

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<sup>12</sup> Consumption of processed dairy products averages 4KG/capita, as against 15-20 KG/capita in Central and Eastern Europe region.

<sup>13</sup> Romania is a traditional exporter of curd and fresh cheese (mainly shipped to Greece).

sector, nonetheless, was considered one of the most sensitive, so that applied rates stood at 45 percent ad-valorem.

In 2006, trade with dairy products involved preferential arrangements with EU, namely 1500 MT of powdered milk and sour cream, 1000 MT of yogurt, 1900 MT of butter and 3000 MT of cheese.

Duty rates' elimination is expected to further increase dairy imports from EU, especially as the domestic currency continues to appreciate against the EURO. At the same time, the pretty high common external tariff (for butter: €1896 per ton, respectively for cheese: levels in most cases exceeding Romania's 45 percent ad-valorem applied until the end of 2006) drastically limit opportunities from other sources.

The future import dynamic depends at the same time by the pace at which the local dairy industry will be able to move toward meeting the EU quality and safety requirements.

## Policy

According to the negotiations on the Chapter 7 (Agriculture) between EU and Romania, dairy premia as referred to in Article 95 of Regulation (EC) No 1782/2003 should be introduced in the same way as direct payments in general, i.e. starting at 25 percent of the (then) applicable EU-15 level in 2007.

The reference dairy cow inventories to supply the negotiated milk quota is 826,216 heads, with an average yield of 3,700 liters/cow/year. According to the EU regulations, these herds need 413,108 ha permanent pastures (maximum 2 large livestock units (LLU)/HA).

Direct payments for milk are evaluated according to the EU regulations EC 1255/1999 amended by EC 1782/2003 namely:

- premia for the amount related to quota starting with 2006-2007 is €24.94 euro/ton;
- additional premia/payment per area of permanent pasture.

The total direct payments per ton of eligible milk (quota) i.e. premia + additional premia/payment per area of pasture cannot exceed in the year 2007 €41.7/ton while the payment per permanent pasture cannot exceed €350/HA (regulations for EU-15).

A study commissioned in 2006 by the European Institute of Romania<sup>14</sup> indicates a scenario through which the maximum level of support for milk and dairy products (through direct payments and national top-ups) is calculated (Tables 4 and 5). The analysis considers that, for reaching the full quota (including the reserve), 877,135 dairy cow heads are needed (with an average yield of 3.7 t/head) and it starts from 155 euro per eligible cow at EU-15 level.

**Table 4. Scenario for Milk Direct Payments in Romania**

	<b>Maximum level of direct payments EU-15 Mil Euro</b>	<b>Possible support to be provided to Romania in 2007 mil Euro (55)</b>	<b>Possible support to be provided to Romania in 2008 mil Euro (60)</b>	<b>Possible support to be provided to Romania in 2009 mil Euro (65)</b>	<b>Possible support to be provided to Romania in 2010 mil Euro (70)</b>	<b>Possible support to be provided to Romania in 2011 mil Euro (80)</b>

<sup>14</sup> THE AGRICULTURAL SECTOR IN THE PERSPECTIVE OF ROMANIA'S ACCESSION TO THE EUROPEAN UNION, Study No. 6.

		percent of EU-15)	percent of EU-15)	percent of EU-15)	percent of EU-15)	percent of EU-15)
<b>Direct payments milk of which:</b>	<b>225,528</b>	<b>124.0</b>	<b>135.3</b>	<b>146.6</b>	<b>157.9</b>	<b>180.4</b>
for premia:	80,940	44.5	48.6	52.6	56.7	64.8
for supplements to premia (psp)	144,587	79.5	86.8	94.0	101.2	115.7
€/eligible animal (3.7 t milk per year)	257	141.4	154.2	167.1	179.9	205.6

Source: THE AGRICULTURAL SECTOR IN THE PERSPECTIVE OF ROMANIA'S ACCESSION TO THE EUROPEAN UNION, Study No. 6, The European Institute of Romania.

To these amounts, based on the Ministry of Agriculture's forecasted budgetary outlays, national top-ups were calculated as follows:

**Table 5. Maximal Complementary Top-ups from the National Budget for Milk**

	2007	2008	2009	2010	2011
<b>Direct payments milk Million euro</b>	<b>124.0</b>	<b>135.3</b>	<b>146.6</b>	<b>157.9</b>	<b>180.4</b>
SAPS for pasture, million euro (413,108 HA necessary for the milk quota)	EC	16.4	17.2	18.1	19.0
National top-ups for milk Total for quota	108.9	118.9	129.3	139.8	161.4
National top-ups for milk €/eligible animal (3.7 t milk per year)	124.1	135.5	147.5	159.3	184.0

Source: THE AGRICULTURAL SECTOR IN THE PERSPECTIVE OF ROMANIA'S ACCESSION TO THE EUROPEAN UNION, Study No. 6, The European Institute of Romania.

Such results indicate that the maximum value of the top-ups admitted to complement the EU direct payments is significant (more than 108 million euro in 2007, 119 million in 2008 and almost 130 million in 2009). Even though actual payments will likely stay at lower levels, they are still expected to have a significant role in modernizing and reshaping the milk sector in Romania in the near future.

## SWINE AND PORK MARKET

Romania's swineherds are overwhelmingly (81 percent in 2005) held in small individual farms and households. This remains to a large extent an obstacle to supplying the processing industry with quality meat, because such farms lack proper feeding and husbandry practices, and generally use poor genetics. The domestic relative shortage made swine meat the top agricultural import into Romania since 2004, with an estimated 9 percent growth in 2006 from the 245,000 MT CWE<sup>15</sup> in 2005.

<sup>15</sup> In product weight equivalent (PWE), pork imports totaled 201,000 MT in 2005.

Inventories have varied little for the past 5 years (registering even some marginal decrease in 2005), but supply has remained very fragmented, despite a number of Governmental support programs.

Forced to compete in the Single Market, Romania's swine industry is encountering significant structural changes. We forecast that very soon only the few farms that invested in technologies will remain operational, on the background of an accelerated industry consolidation and vertical integration.

Nonetheless, the sector has the potential to grow overall, based on a number of favorable factors:

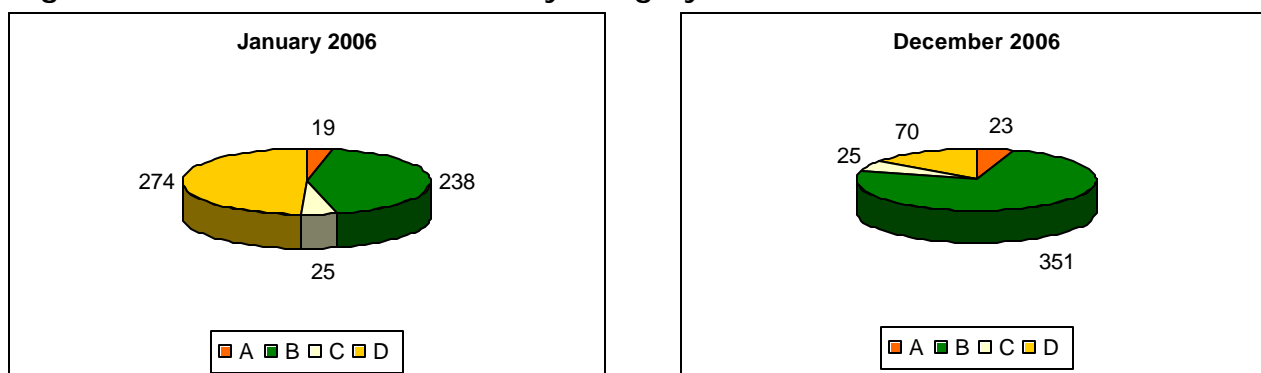
- Despite still low (by western standards) consumption levels, pork is traditionally preferred by the average Romanian consumer. The domestic market is large and continues to grow, in tandem with the purchasing power of the population.
- The normally low price of feed grains (especially corn), as Romania is the second largest corn producer in EU.
- The still relatively cheap labor costs.
- A notable presence of foreign and local investors in the pre-accession period, likely to market consolidation.
- A generally good condition of the environment.

At the same time, Romania's swine industry faces a number of constraints at present:

- Price volatility for pork, with a trend towards depreciation in 2007 and 2008 (see section on Trade).
- Domestic producers cannot benefit from the access to the enlarged market, as Romania continues to fight classical swine fever. At the same time, other EU members have free access to the Romanian market.
- The local currency is expected to continue its appreciation vis-à-vis Western currencies.

In terms of country's food safety preparedness, progress was visible in the pre-accession year (Figure 2). When closing its negotiations on agriculture in 2004, Romania was granted a transition period until December 31, 2009 for modernizing and upgrading its slaughtering and meat processing units, in compliance with the EU requirements, while products from establishments subject to transitional arrangements will not be sold to other Member States and will be clearly identified. In December 2006, right before Romania's EU membership, out of 469 red meat plants, almost 70 percent were expected to be fully compliant with the EU requirements by the accession time. This evolution reflects the acceleration of the SAPARD funding absorption in 2006, many establishments being able to access money for revamping their operations.

**Figure 2. Red Meat Establishments by Category**



- A: Plants that fully meet EU requirements.
- B: Plants expected to be EU compliant by the date of accession.
- C: Plants expected to meet EU requirements by the end of 2009.
- D: Plants to be shut down by the date of accession.

## Trade

Given the situation of domestic supplies in Romania, very fragmented and originating from units inconsistent in terms of technical endowment, pork imports have been Romania's top agricultural import for the past three years, peaking in 2006.

Major suppliers were EU member countries (Germany, France, Spain), but also Canada and US until October 2006, when Romania starting applying the EU sanitary-veterinary regime. Under such circumstances, prices prevailing on the domestic markets were import prices plus transportation costs. In addition, most imports were taxed at 45 percent (just 23,000 MT of swine meat entering duty-free under a preferential TRQ that operated in 2006). These elements combined resulted in levels with 20-22 percent above the EU pork prices in 2006.

The effects of the intra-community trade liberalization have become visible already in January 2007, when retail prices for meat cuts and processed pig meat products registered a 7-10 percent reduction. Industry representatives estimate that pork prices will be down 10-15 percent in 2007 compared to 2006.

## Policy

In 2006, the Ministry of Agriculture allocated important amounts (96 million RON, as per the latest amendments passed in August) for direct subsidies to hog growers. Eligible recipients were farms compliant with specified biosecurity measures, delivering pigs to authorized slaughterhouses. The unit subsidy varied according to the quality class of the carcass (classified under the EUROP system), as follows: 120 RON/head for hogs in the "E" category; 100 RON/head in the "U" category. Carcasses classified as "R", "O" or "P" were not eligible for market price support. Ecologically grown hogs from "E" and "U" quality classes were paid 120 RON/head.

This policy was considered beneficial by the Hog Producer Association, especially on the background of the need to restructuring the sector and coagulating the producers in industry groups. Given the fact that EU does not provide support (in the form of direct payments) to this industry, but allows Romania to continue its subsidization scheme from the national budget in the first three years after accession, the GOR decided to extend in 2007 the same assistance mechanism at levels at least comparable to the 2006 budgetary outlays<sup>16</sup>.

## POULTRY MARKET

Data provided by the Romanian Association of Poultry Producers confirm our August 2006 forecast (RO6018), indicating a reduction in both inventories and broiler production in industrial operations in 2006. The explanation for this evolution continues to be the effects of the widely spread avian influenza outbreaks in Romania from the first half of the year (that

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<sup>16</sup> The level of support was not published at the time this report is being prepared.



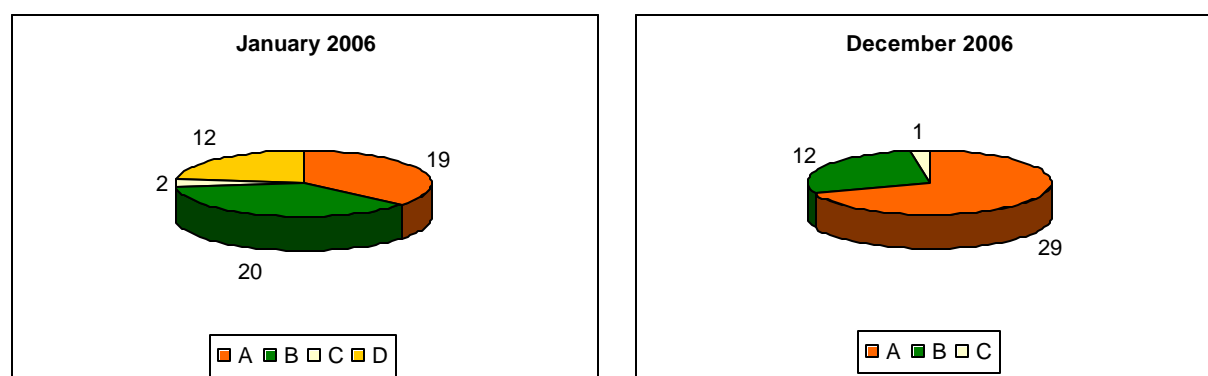
affected consumption), combined with some incertitude until recently regarding the support policy of the GOR in 2007, as the sector is not eligible for EU direct payments.

Despite the slowing down registered by Romania's poultry industry in 2006, we anticipate that commercial operators will be able to recover rapidly and resume growth from 2007, given their overall performance indicators. Even in the enlarged market, production costs (especially the cost of feed grains and labor) should be instrumental to sector's competitiveness. Broiler production, is expected to increase three-fold in the coming three-four years, in parallel with an accelerating market concentration<sup>17</sup>. Egg production has started to decline, again a natural process from the perspective of the enlarged EU market.

A peculiarity for Romania remains the significant household backyard production, that supplies one third of the poultry meat domestic consumption, but it is expected to shrink rapidly in the coming years.

Local operations (often vertically integrated from feed production to hatchery, production and further to slaughtering and processing, or even distribution) made fundamental modernization efforts in the pre-accession years, in order to become EU-compliant (Figure 3). This covers a wide range of aspects, from animal welfare to slaughtering equipments and technology (e.g., immersion chilling was changed into air chilling tunnels). Most plants were able to move up into the "A" and "B" categories by the date of accession, as they submitted restructuring plans (mainly under SAPARD funding). Given the transition period granted to the sector, after country's EU admission products from establishments subject to upgrades will not be sold to other Member States and will be clearly identified.

**Figure 3. Poultry Meat Plants by Category**



A: Plants that fully meet EU requirements.

B: Plants expected to be EU compliant by the date of accession.

C: Plants expected to meet EU requirements by the end of 2009.

D: Plants to be shut down by the date of accession.

## Trade

Despite the rapid expansion of domestic broiler production in the recent years, Romania was a net importer of poultry meat for the past decade, in fact this product becoming in 2005 the country's second largest agricultural import<sup>18</sup>, while the US the main supplier.

<sup>17</sup> Concentration in the poultry industry is already high: the seven largest operations were holding, in mid-2006, roughly 50 percent of country's commercial production, but small players, producing 1,500-2,000 MT/year, are still numerous.

<sup>18</sup> Without considering tobacco and cigarettes.



Far in advance to its EU accession, Romania implemented trade protectionist measures, through both tariff measures (from February 2006) and SPS barriers (August 5, 2006) (See RO6017), allegedly to give local industry time to recover after the avian influenza crisis.

Under such circumstances, total broiler meat amount imported into Romania in 2006 shrank by an estimated 15 percent (based on provisional data). After country's EU membership, assuming that domestic production will be able to adapt rapidly to the enlarged market's conditions, imports will continue to fall. Export opportunities for US poultry meat were shut down through the adoption of the EU veterinary *acquis*. In the short run, Brazil will likely be able to substitute part of the amount traditionally shipped by US, while another share will be grasped by the EU member states.

## Policy

Similarly to the situation in the swine industry, as poultry production is not eligible for EU support, the GOR decided for 2007 to continue its past programs to stimulate poultry inventories and production from the national budget. Several support measures qualify as "Green Box"-type and are exempted from the reduction commitment (e.g., budgetary allocations to preserve the breeding stock). Market price support (disbursed as procurement payments) is provided for broiler meat and count in the Aggregate Measurement of Support.

At the time this report is prepared, the Ministry of Agriculture has not published figures regarding the subsidy/head<sup>19</sup> (payable for broilers delivered for slaughtering at approved slaughterhouses and weighting at least 1.75 KG) or the total budgeted amount. Attached to the eligibility criteria is also that poultry comes from farms compliant with biosecurity requirements.

Qualifying as "state aid", such support may be provided in the first three years after the accession.

## WINE MARKET

Wine is one of the sectors generating hard currency gains to Romania's economy, as the product is being traditionally shipped to EU (Germany, UK), US, Russia etc. Nonetheless, in 2006, the trade balance for wine deteriorated, with large imports from Moldova, Spain, Italy.

Vineyards cover about 1.5 percent of country's agricultural land, generating some 12-15 percent of the agricultural output value.

It is generally expected that accession will impact significantly the sector, especially through the liberalization of the intra-community trade regime, but also as the common external tariff (CXT) of 32 Euro per hl is considerably lower than Romania's 60 percent ad-valorem applied until the end of 2006. Adding to these, the area planted to vineyards will shrink, in accordance with the negotiations with EU concerning the wine sector. Romania was granted a transition period ending 31 December 2014 for removing the prohibited hybrid varieties, cultivated on an area of 30,000 hectares, and for replanting with vine varieties included in the accepted grapevine, with the recognition of these replanting rights. This will generate additional costs related to establishing new vineyards.

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<sup>19</sup> In the beginning of 2006, the amount was set up at 1.4 RON/head and doubled in June, as emergency assistance to poultry growers. From October, it went back to its initial level.

Competition from abroad will likely force local producers to increase the quality and cut on prices. Despite the fact that Romania is an import wine producer in Europe, many companies do not seem able to adapt themselves to the new market conditions. Industry consolidation will continue to grow and just those companies who invested in quality, production and marketing to attract constant consumers will be able to survive. Currently, the four largest producers hold 70 percent of the domestic market.

In 2006, white wines represented 70 percent of domestic wine consumption, but red wines are slightly winning market share. By type, 46 percent of the locally sold wines were dry, 52 percent were sweets and semi-sweets, while 2 percent were liquored. There is an increasing trend demi-dries on the medium priced segment, while on the premium quality wine segment, consumption of dries is growing fast.

In January-October 2006, Romania imported 585,000 HL (mainly from Moldova and EU, under preferential arrangements). Imports from third countries (Chile, Australia, US, South Africa, Argentina) are expected to increase their market share in Romania from 2007.

Initial figures advanced by GOR officials indicate that in 2007 the sector will attract investment of about 70 million euro, of which about 20 million from EU structural funding for agriculture and rural development.